



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Report of the auditor-general to the North West provincial legislature and the council on the Tswaing Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Tswaing Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.



Basis for qualified opinion

Trade receivables from exchange transactions

6. The municipality incorrectly recognised debtors that no longer exist, did not include government debtors in the allowance for impairment, did not correctly calculate the allowance for impairment to assess individual significant debtors, did not charge interest on outstanding accounts and did not ensure that trade receivables from exchange transactions as disclosed in note 5 to the annual financial statements correctly disclosed the ageing per service as required by GRAP 104 *Financial instruments*. Consequently, trade receivables from exchange transactions and VAT payable as per the statement of financial position was overstated by R21 568 919 and R2 761 284 respectively and revenue from exchange transactions and debt impairment as per the statement of financial performance was understated by R8 903 599 and R27 711 233 respectively. Additionally, there was a resultant impact on the deficit for the year and the accumulated surplus.
7. During 2015, I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions as the municipality did not maintain adequate records of debtors' payments to ensure that the allowance for impairment had been accounted for correctly. I was unable to determine whether any adjustments to debt impairment in the statement of financial performance of R15 726 870 or the related allowance for impairment of R196 050 744 as disclosed in note 5 to the annual financial statements, was necessary. In addition, the municipality did not disclose receivables from non-exchange transactions separately from receivables from exchange transactions as required by GRAP 1 *Presentation of financial statements*. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm these receivables by alternate means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Payables from exchange transactions

8. I was unable to obtain sufficient appropriate audit evidence for trade payables and retentions included in payables from exchange transactions as information requested from management were not available for audit due to a lack of proper record keeping. I was unable to confirm these payables by alternative means. Consequently, I was unable to determine whether any adjustment relating to trade payables of R93 077 984 and retentions of R3 813 170 included in payables from exchange transactions payables from exchange transactions disclosed note 12 in the financial statements was necessary.

Unallocated receipts

9. The municipality did not accurately account for unallocated receipts as required by GRAP 1 *Presentation of financial statements* as these receipts were not allocated to consumer debtors. Consequently, unallocated receipts as per the statement of financial position were overstated by R7 140 932 and trade receivables from exchange transactions were overstated by the same amount.

Revenue from exchange transactions

10. During 2015, I was unable to obtain sufficient appropriate audit evidence that the municipality properly charged and accounted for the sale of electricity and water as the municipality could not provide proper substantiating records for water and electricity consumption. In addition, the municipality did not account for all service charges as revenue in accordance with GRAP 9 *Revenue from exchange transactions* as the municipality did not maintain adequate records on the indigent debtors. I was unable to determine whether any adjustment to revenue from the



sale of electricity of R32 953 203 and sale of water of R5 308 271 included in service charges disclosed in note 18 and the related trade receivables from exchange transactions of R28 105 845 in the statement of financial position was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm this revenue and receivables by alternate means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Revenue from non-exchange transactions

11. During 2015, I was unable to obtain sufficient appropriate audit evidence that the municipality properly levied and accounted for property rates in accordance with GRAP 23 *Revenue from non-exchange transactions* due to the lack of a reliable valuation roll and indigent debtor register. I was unable to determine whether any adjustment to property rates of R13 110 900 as per the statement of financial performance and the related rates receivable of R51 922 208 included in trade receivables from exchange transactions as disclosed in note 5 to the annual financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm this revenue and receivables by alternate means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Debt impairment

12. The municipality did not accurately account for the allowance for debt impairment as required by GRAP 104 *Financial instruments* as the VAT portion were included in the debt impairment expense and not accounted for separately in the VAT control account. Consequently, the debt impairment expense as per the statement of financial performance was overstated by R2 057 307 and the related VAT payable as per the statement of financial position was overstated by the same amount. Additionally, there was a resultant impact on the deficit for the year and the accumulated surplus.

Cash flow statement

13. I was unable to obtain sufficient appropriate audit evidence that non-cash items were appropriately accounted for in municipality's calculation of net cash flows from operating activities and cash generated from operations as required by of GRAP 2 Cash flow statements. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustment relating to net cash flows from operating activities and cash generated from operations in the cash flow statement and notes thereto was necessary in the current and prior year.

Statement of comparison of budget and actual amounts

14. The municipality did not accurately present budget information in the statement of comparison of budget and actual amounts as required by GRAP 24 *Presentation of budget information in the financial statements*. The amounts disclosed as the final budget in the statement of comparison of budget and actual amounts is understated by R12 721 612 when compared to the amounts as per the approved budget of the municipality. Additionally, there was a resultant impact on the differences and variances disclosed.

Unauthorised expenditure

15. I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure as the information and explanations I considered necessary was not available due to a lack of

proper record keeping. I was unable to confirm unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to unauthorised expenditure of R106 563 155 (2015: R66 793 073) disclosed in note 44 to the annual financial statements was necessary.

Irregular expenditure

16. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R2 679 048 (2015: R24 043 168) in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. In addition, the municipality disclosed irregular expenditure that were not in contravention with the supply chain management requirements and did not meet the definition of irregular expenditure resulting in irregular expenditure being overstated by R63 695 056. Consequently, irregular expenditure as per note 46 to the financial statements was overstated by R36 972 840 (2015: understated by R24 043 168).

Material losses

17. The municipality did not disclose material water distribution losses in the prior or current year, as required by section 125(2)(d)(i) of the MFMA. This was due to a lack of proper monitoring controls. I was unable to determine the full extent of the water distribution losses as it was impracticable to do so.

Qualified opinion

18. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Tswaing Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA.

Emphasis of matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Fruitless and wasteful expenditure

20. As disclosed in note 45 to the financial statements, fruitless and wasteful expenditure of R5 317 737 was incurred in the current year and fruitless and wasteful expenditure from prior years of R7 893 564 had not yet been dealt with in accordance with section 32 of the MFMA.

Material losses

21. As disclosed in note 48 to the financial statements, material losses to the amount of R11 114 378 (2015: R11 378 375) were incurred as a result of electricity losses.

Going concern

22. Note 42 to the financial statements indicates that the Tswaing Local Municipality incurred a net loss of R18 965 724 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R94 889 488. These conditions, along with other matters as set forth in note 42, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Restatement of corresponding figures

23. As disclosed in note 40 to the financial statements, the corresponding figures for 2015 have been restated as a result of errors discovered during 2016 in the financial statements of Tswaing Local Municipality at, and for the year ended, 30 June 2015.

Additional matter

24. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

25. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

26. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

27. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2016:
- KPA 2: Local economic development and spatial rational on page XX to XX
 - KPA 5: Basic service delivery and infrastructure investment pages XX to XX
28. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).
29. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
30. The material findings in respect of the selected development priorities are as follows:

KPA 2: Local economic development and spatial rational

Usefulness of reported performance information

31. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported targets are not consistent with the targets as per the approved integrated development plan.

32. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:
- A total of 100% of the indicators were not well defined.
 - A total of 60% of the indicators were not verifiable.
 - A total of 60% of the targets were not specific.
 - The required performance for 60% of the targets could not be measured.

Reliability of reported performance information

33. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

KPA 5: Basic service delivery and infrastructure investment

Usefulness of reported performance information

34. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:
- A total of 83% of the indicators were not well defined.
 - A total of 83% of the indicators were not verifiable.
 - The required performance for 83% of the targets could not be measured.

Reliability of reported performance information

35. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Additional matters

36. I draw attention to the following matters:

Achievement of planned targets

37. Refer to the annual performance report on pages XX to XX and XX to XX for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs 31 to 35 of this report.

Unaudited supplementary schedules

38. The supplementary information set out on pages X to X does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

39. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Human resource management

40. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
41. The competencies of the chief financial officer, head of supply chain, financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
42. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.
43. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

Annual financial statements and annual report

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current asset, current assets, net assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
45. The annual performance report for the year under review did not include a comparison with the previous financial year as required by section 46(1)(b) of the MSA.
46. The 2014-15 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

Budgets

47. Expenditure was incurred in excess of the approved budget in contravention of section 87(8) of the MFMA.
48. Unforeseen and unavoidable expenditure incurred by the municipality was not approved by the mayor as required by section 29(1) of the MFMA on expenditure that could have waited for the adjustment budget.

Procurement and contract management

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulations 17(a) and (c).
50. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for quotations, in contravention of SCM regulations 21(b)



and 28(1)(a) and the Preferential Procurement Regulations.

51. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
52. Awards were made to providers who were in the service of other state institutions or whose directors / principal shareholders were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).

Revenue management

53. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
54. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
55. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

56. I could not obtain sufficient appropriate audit evidence that investments made in JSE listed shared were made in accordance with regulation 6 of the Municipal investment regulations.
57. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

58. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by sections 32(2)(a) & (b) of the MFMA.

Expenditure management

59. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability management

60. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
61. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Strategic planning and performance management

62. The key performance indicators set by the municipality did not include indicators on percentage of households with access to basic level of water, sanitation and solid waste removal set by the municipality as required by section 43(2) of the MSA and the regulation 10(a) of the Municipal planning and performance management regulations.
63. The integrated development plan was not reviewed annually as required by section 34 of the MSA and regulations 3 and 11 of the Municipal planning and performance management

regulations.

64. The performance management system and related controls were inadequate as the described processes for performance review, reporting and how it is conducted, organised and managed were not implemented, as required by section 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Environmental management

65. The municipality did not exercise its legislative and executive authority of managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment as required by section 11(3)(l) and (m) of the MSA.
66. The municipality operated its wastewater treatment facilities without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
67. The municipality's operational activities at its waste disposals sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license or the norms and standards as prescribed by sections 67(1)(f) and (h) of the NEMWA and sections 151(1)(c) and (i) of the NWA.
68. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

Internal control

69. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

70. The leadership's philosophy and operating style is not contributing towards a clean administration. This is evidenced by the lack of implementation and monitoring of action plans to address prior year audit findings, the establishment of a culture of honesty, ethical business practices and good governance. Leadership failed to appoint sufficient appropriately skilled staff in key positions within the finance unit and the training and development initiatives failed to address the underlying deficiencies that caused matters to be reported on repeatedly.

Financial and performance management

71. The accounting officer did not adequately monitor reporting, compliance with laws and regulations and internal control as supporting documentation submitted during the audit did not adequately support disclosures while management failed to respond to critical audit issues. The inability of management to address prior year audit findings and staff in finance not understanding the requirements of the financial reporting framework is concerning. Management's lack of commitment to address repetitive findings relating to supply chain management regulations might be a possible indicator of financial misconduct.

Governance



72. The accounting authority failed to install good governance principles within the entity. These include the development and implementation of a risk management policy, fraud prevention plan and effective application of recommendations made by internal and the audit committee did not fulfil their legislative responsibilities.

Other reports

73. I draw attention to the following engagement that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of this engagement that is in progress.

Investigations

74. An independent consulting firm are performing an investigation at the request of the Tswaing Local Municipality, which covered the period 18 June 2015 to 30 June 2016. The investigation is on the previous municipal manager and director of corporate services on alleged financial misconduct. The investigation was still on going at the date of the audit report.

AUDITOR GENERAL

Rustenburg

30 November 2016



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SOUTH AFRICA

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